IT 98-0006-GIL 01/12/1998 SUBCHAPTER 'S' CORPORATIONS

General Information Letter: Response to questions regarding taxation of Qualified Subchapter S Subsidiaries.

January 12, 1998

Dear:

This is in response to your letter dated January 9, 1998, in which you request a letter ruling. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of agency policy that apply, interpret or prescribe the tax laws and are not binding on the Department. For your general information we have enclosed a copy of 2 Ill. Adm. Code Part 1200 regarding rulings and other information issued by the Department.

Although you have not specifically requested either type of ruling, the nature of your question and the information provided require that we respond only with a GIL.

In your letter you have stated the following:

> Could you please answer the following questions pertaining to the new federal law whereby a Federal S Corporation is allowed to own 100% ownership interest in another corporation known as a qualified Subchapter S subsidiary:
>
> A. How will Illinois tax a federal S corporation that creates a qualified subchapter s subsidiary? Will the return be filed at the subsidiary level that is doing business in the state or will the parent company be the filer of the corporate return?
>
> B. Is there any type of franchise tax or capital tax that the S Corporation is responsible to file? If so, is the return filed at the subsidiary level or by the parent company?
>
> Copies of the applicable tax code section, if any, addressing these issues will be greatly appreciated.

Ruling

Section 1501(a)(28) of the Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 *et seq.*) provides:

> The term "Subchapter S corporation" means a corporation for which there is in effect an election under Section 1362 of the Internal Revenue Code . . .

Section 1362 of the Internal Revenue Code permits a "small business corporation" to elect taxation as a Subchapter S corporation. The term "small business corporation" is defined in Section 1361(b) of the Internal Revenue Code, which provides, in part:

> (3) TREATMENT OF CERTAIN WHOLLY OWNED SUBSIDIARIES.-- (A) IN GENERAL.--For purposes of this title--
>
> (i) a corporation which is a qualified subchapter S subsidiary shall not be treated as a separate corporation, and
>
> (ii) all assets, liabilities, and items of income, deduction, and credit of a qualified subchapter S subsidiary shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.
>
> (B) QUALIFIED SUBCHAPTER S SUBSIDIARY.--For purposes of this paragraph, the term "qualified subchapter S subsidiary" means any domestic corporation which is not an ineligible corporation (as defined in paragraph (2)), if--
>
> (i) 100 percent of the stock of such corporation is held by the S corporation, and
>
> (ii) the S corporation elects to treat such corporation as a qualified subchapter S subsidiary.

Section 102 of the IITA provides:

> Except as otherwise expressly provided or clearly appearing from the context, any term used in this Act shall have the same meaning as when used in a comparable context in the United States Internal Revenue Code of 1954 or any successor law or laws relating to federal income taxes and other provisions of the statutes of the United States relating to federal income taxes as such Code, laws and statutes are in effect for the taxable year.

Section 1501(a)(4) of the IITA provides:

> The term "corporation" includes associations, joint-stock companies, insurance companies and cooperatives. Any entity, including a limited liability company formed under the Illinois Limited Liability company Act, shall be treated as a corporation if it is so classified for federal income tax purposes.

Pursuant to Section 1361(b)(3) of the Internal Revenue Code, a qualifying Subchapter S subsidiary ("QSSS") is not a separate corporation, but rather is defined to be a part of its parent Subchapter S corporation for all purposes of the Internal Revenue Code. Because this definition is expressly adopted by the IITA, a QSSS is not a separate corporation for Illinois income tax purposes. Instead, the QSSS is by definition part of its parent Subchapter S corporation, and its assets, liabilities, and items of income, deduction, and credit must be included with the assets, liabilities, and items of income, deduction, and credit of its parent Subchapter S corporation in determining the Illinois income tax liabilities of the parent and its shareholders.

Applying these statutory provisions to the facts described in your letter, the answers to your specific questions are as follows:

A. How will Illinois tax a federal S corporation that creates a qualified subchapter s subsidiary? Will the return be filed at the subsidiary level that is doing business in the state or will the parent company be the filer of the corporate return?

The Subchapter S corporation and the QSSS will be treated as a single Subchapter S corporation, and the parent will have the responsibility of filing Illinois Income Tax returns.

B. Is there any type of franchise tax or capital tax that the S Corporation is responsible to file? If so, is the return filed at the subsidiary level or by the parent company?

e Illinois Department of Revenue does not administer the franchise tax. For questions regarding the franchise tax, please contact:

Office of the Illinois Secretary of State
Department of Business Services
Room 328
Springfield, Illinois 62756

As stated above, this is a GIL which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you wish to obtain a PLR which will bind the Department with respect to the application of the law to specific facts, please submit a request conforming to the requirements of 2 Ill. Adm. Code Part 1200. Please note, however, that a PLR cannot apply the law to a hypothetical situation and a PLR is not binding with respect to a statement of facts which is incomplete or incorrect. Accordingly, the Department does not ordinarily issue PLRs in response to requests based on unsupported conclusions of fact or which are, in effect, requests for determinations of fact. Given the inherently factual nature of the issues in your inquiry, we believe it is unlikely that we will be able to issue a PLR in this instance.

Sincerely,

Paul S. Caselton
Senior Counsel -- Income Tax